



2016 Annual Economic Report

Making Germany fit for the future – taking the opportunities of digital transformation

1. Germany is enjoying solid growth. Despite the difficult international environment, Germany's economy grew by a total of 1.7% last year. Unemployment is at its lowest level since the country's reunification. Last year, real gross wages and salaries per employee recorded the highest increase for more than two decades. The budget of the Federation, the Länder, the municipalities and the social insurance funds was close-to-balance in 2015 for the fourth year in succession. Working from what is a fundamentally favourable situation, the Federal Government is continuing its economic and fiscal policy aimed at investment and sustainable growth. A key role here is played by digitisation. The Federal Government is embracing the digital transformation and is working with businesses, trade unions, the scientific community and civil society to put the conditions in place for successful digitisation. We need to adapt the regulatory framework of the Social Market Economy to the requirements of the digital world and – both at national and at European and international level – to create scope for innovation and to permit the individual to retain control of his/her data.

2. The upturn in the German economy softened somewhat in the second half of last year. The slower growth in the emerging economies meant less dynamic exports and corporate investment. However, industrial demand picked up again towards the end of the year. At the same time, business sentiment improved. The labour market continued to develop favourably right up to the end of the year. The ongoing economic dynamism is mainly being driven by the domestic economy, and particularly by consumer spending and investment in housing construction. The low oil price and the comparatively weak euro exchange rate are also having a positive impact on economic development. On the other hand, the fall in growth in many emerging economies continued to reduce the rate of growth.

3. For 2016, the Federal Government expects an annual average increase in gross domestic product of 1.7%

(cf. Overview 1). Adjusted for working days, gross domestic product will grow by 1.6% this year, or 0.1 percentage points more than last year. The continuing expansion of employment, together with the appreciable rises in income, forms the foundation of the ongoing dynamism in Germany's domestic economy. As in previous years, the additional employment will chiefly be created in the services sectors.

4. As demand picks up speed, the companies will gradually step up their investment over the course of the year. Despite this, inflationary tensions are not expected. Macroeconomic capacity utilisation will be generally normal. Profits will increase this year, not least due to falling oil prices; the share of wages is likely to decline slightly. Unit wage costs will mark a moderate rise.

5. A central assumption for the projection is that the financial sector will remain stable and there will be no negative developments in the eurozone or the world economy which will cause a significant rise in uncertainty in the economy.

6. The high influx of refugees will not initially have a significant impact on the labour market. But the influx will create enormous new challenges. In recent months, numerous steps have been taken at national and international level aimed at reducing immigration without placing a question mark over the fundamental right to asylum. The Federal Government is also trying to achieve rapid and sustainable integration into the labour market for refugees with good prospects of remaining in Germany.

7. Digitisation brings with it major opportunities for society and opens up enormous potential for additional value creation. It is primarily up to the companies to take an open-minded, flexible and innovative look at their business models and to develop new ones. The Federal Government is providing appropriate infrastructures and a digital-friendly environment to foster this digital trans-

formation. It is continuing to develop the regulatory framework and is taking account of the special features of digital markets.

8. This spring, the Federal Government will present a draft for a ninth amendment to the Act against Restraints on Competition which will take account of the needs of the advances in digitisation. Also, the draft envisages an improvement in the private enforcement of antitrust law so that victims can obtain redress more quickly and more simply. The revision of the Act is also intended to ensure that companies cannot evade fines imposed by cartel authorities by changing their legal structure. In future, parent companies will be liable for antitrust violations by their subsidiaries.

9. The Federal Government has launched a comprehensive modernisation of the law on public procurement and concessions. The aim is to create simple and user-friendly rules for public procurement which offer greater flexibility for the awarding of public contracts. Basically, communication between contracting authorities and businesses, and the exchange of documents, will take place online in future. This will make the procurement procedures quicker and more efficient. In this way, public procurement will keep pace with the digital transformation.

10. As a result of increasing digitisation, the storing and sharing of personal data has long since become part of everyday life. The General Data Protection Regulation will put a uniform European legal framework in place for

the processing of personal data. This is to take account both of basic EU data protection law and of justified interests of society in general and of the data processor.

11. In addition to protection for personal data, continuing digitisation necessitates further measures in the field of IT security. The Federal Government's IT Security Act has therefore significantly improved the security of IT systems by prescribing minimum standards and reporting requirements for major IT security incidents.

12. In order to give companies greater scope in which to act, the Federal Government is continuing to reduce red tape. The biggest improvements for business in 2015 come from the Act to Reduce Bureaucracy, which is lowering the burden by around €700 million, and the modernisation of procurement law, which is lessening the cost of red tape by more than a billion euros. In March 2015, the Federal Government introduced a new brake on bureaucracy in the form of a "one in, one out" principle. This approach is based on the concept that any new regulations affecting businesses have to be offset by a reduction of the same amount of bureaucracy.

13. With a view to facilitating access to venture capital for innovative start-ups, the Federal Government adopted measures in September 2015 to improve the policy environment for venture capital and start-ups in Germany. As announced in the cabinet's document containing key points on venture capital, it will continue this strategy. Germany is to become more attractive for venture capital, not least in terms of the tax rules.

Overview 1: Selected key figures for macroeconomic trends in the Federal Republic of Germany¹

	2014	2015	annual projection 2016
	Percentage change on preceding year		
Gross domestic product (GDP), output approach			
GDP (real)	1.6	1.7	1.7
Total employment	0.9	0.8	0.9
Unemployment rate in % (Federal Employment Agency definition) ²	6.7	6.4	6.4
GDP by expenditure (real)			
Private consumption expenditure	0.9	1.9	1.9
Machinery and Equipment	4.5	3.6	2.2
Construction	2.9	0.2	2.3
Domestic demand	1.3	1.6	2.3
Exports	4.0	5.4	3.2
Imports	3.7	5.7	4.8
External balance of goods and services (contribution to GDP growth) ³	0.4	0.2	-0.4
Total gross wages and salaries per employee	2.7	2.9	2.6

1 Up to 2015 results of the Federal Statistical Office; National Accounts Status: January 2016.

2 In relation to the total labour force.

3 Absolute change external balance in per cent of pre-year GDP (= contribution to change in GDP).

14. The Federal Government is taking a comprehensive approach to strengthening both public and private-sector investment, and has already taken numerous measures in this legislative term to give a further boost to investment dynamism. In addition to this, the Federal Government is considering the following measures in particular in the context of its investment strategy in order to give a lasting boost to investment activity: the continuing development of the Joint Scheme “Improving the Regional Economic Structure”, the establishment of a centre of excellence for planning and implementing municipal investment projects, and the improvement of the legal and institutional environment for private-sector financing of infrastructure. Also, the Federal Government increased investment in transport infrastructure in 2015 and will continue this process.

15. The infrastructure of efficient broadband networks is just as important as good roads and railways for a modern, digitally connected economy and society. Successful participation in the opportunities of digitisation requires nation-wide, high-performance network infrastructure. The Federal Government’s aim is to vigorously continue the roll-out. In the liberalised telecommunication market, the broadband roll-out is primarily the task of the telecommunication firms. For the future, the availability of optical fibre must continue to increase substantially in order to enable internet access with constantly high bandwidth in the range of gigabit per second. The Federal Government is supporting the expansion of broadband by adapting the legal framework accordingly. It is promoting the expansion of broadband on a technologically neutral basis in regions in which market-based expansion by private-sector investment alone is uneconomic.

16. In order to develop the potential for innovation offered by digitisation, the Federal Government has set up a number of technology promotion programmes and has initiated dialogue processes with the relevant stakeholders. The new High-tech Strategy brings together Federal Government activities to promote research and innovation. The Strategy aims at further strengthening Germany’s position in the global rivalry between the knowledge-based societies. Also, the funding programmes for innovative SMEs have been made more transparent and stronger; the technology-neutral innovation policy gives structured backing to the process from the idea through to success on the market.

17. Digitisation and networking of industrial production processes along the entire value chain (“Industrie 4.0”) is heralding customised production and products, along with efficiency gains, and is paving the way for new busi-

ness models. Small and medium-sized enterprises in particular will find that digitisation is a key to maintaining their competitiveness. The Federal Government is supporting their efforts to master the challenges.

18. The Federal Government is successfully continuing its growth-oriented and sustainable fiscal policy. Last year, the overall public-sector finances were again in the black, at 0.5 % of GDP. This means that the public-sector budgets were close-to-balance for the fourth year in succession. The Federation made a substantial contribution towards this success. Germany is in compliance with the national and European fiscal rules and is thus helping to rapidly reduce the debt-to-GDP ratio.

19. The Federal Government’s goal of cutting the debt-to-GDP ratio to less than 70 % will be attained by the end of 2016. This puts a platform in place from which to fulfil the plans to cut the debt-to-GDP ratio to below 60 % in a ten-year period.

20. At the same time, the Federal Government is placing a clear emphasis on public-sector investment. For example, the funding for efficient transport infrastructure has been clearly increased in the federal budget, and more money has been allocated to the Energy and Climate Fund. However, since the bulk of public-sector investment is realised by the Länder and the municipalities, the Federation is also providing considerable financial relief to those levels of government in order to enable them to finance their work in the fields of infrastructure, education and child-care services in particular. Further to this, the Federation is also providing more than six billion euros of funding to the Länder in 2015 and 2016 to help them cope with the tasks related to the reception and accommodation of refugees and asylum seekers in the coming years. Up to 2019, the Federal Government is providing them with a total exceeding €45 billion to give them additional scope for public-sector investment.

21. One key priority of the Federal Government in the field of tax policy is on greater international and European fairness in taxation. The fight in the OECD context against the shifting of profits across borders by companies which operate internationally is a central objective of taxation policy in the current legislative term.

22. If German tax law is to be able to continue to meet the needs of a modern society in a globalised world, it must be continuously developed. In order to prevent jobs in a business structure dominated by small and medium-sized enterprises from being endangered, the aim continues to be to alleviate in a constitutionally compli-

ant manner the effects of inheritance and gift tax on the acquisition of corporate assets subject to preferential tax treatment. The Federal Government is also aiming to undertake a comprehensive reform of investment tax law.

23. Digitisation also opens up new possibilities to make the taxation procedure more efficient. Working together with the Länder, the Federal Government aims to keep modernising the tax collection processes. This includes the expansion and further development of IT support, a more service-oriented fiscal administration, and structural procedural changes.

24. The Federal Government is aiming to systematically re-order the fiscal relations between the Federal and Länder governments for the post-2019 period. The Federal Government would like to arrive at a result together with the Länder during this legislative term which meets the interests of the Federation and the Länder. In this context, the intention is also to re-orient regional economic assistance to fit the situation of structurally weak regions throughout Germany.

25. Last year, an average of 43 million people were in gainful employment, more than ever before. The trend towards higher employment is continuing. The current employment situation must not however be allowed to hide the fact that the ageing of the population will very probably result in a drop in the total labour force in the coming decades. Increased immigration of skilled workers and the integration of refugees into the labour market can alleviate but not reverse the consequences of demographic change. The Federal Government's economic policy therefore aims to continue to boost labour force participation. The policies include a further expansion of child-care services, which make a key contribution toward helping parents combine work and family life. In terms of the employment of older workers, the Federal Government is planning measures to flexibilise the transition from working life to retirement.

26. The rate of immigration has reached a new record due to last year's dramatic rise in refugee flows. In view of this, the Federal Government is working intensively to ensure orderly and controlled immigration of refugees. Irrespective of the future development of refugee numbers, it is already clear for those refugees in Germany who have the prospect of permanent residency that rapid involvement in working life is key for both economic and social integration. For this reason, the Federal Government has taken a large number of steps to speed up the procedures and to grant refugees with a good

prospect of permanent residency more rapid access to the labour market. At the same time, the services on offer in terms of active labour-market policy have been expanded, and extra funding allocated for language and integration courses.

27. If there are to be more skilled workers in the medium to long term, the attractiveness and quality of vocational training is of key importance. In the context of the "Alliance for Initial and Further Training 2015–2018", the Federal Government is working with the business community, the trade unions, the Länder and the Federal Employment Agency to point every young person interested in vocational training towards a "path" which offers a vocational qualification as quickly as possible.

28. The digitisation is going hand in hand with a far-reaching change in the world of work which extends much further than the use of information and communication technology. The Federal Government is working actively on this process. The "Work 4.0" dialogue process is creating the framework for a public and expert dialogue on the future of the world of work. The results of the dialogue process are to be presented in a White Paper at the end of 2016.

29. The introduction of the nation-wide statutory minimum wage on 1 January 2015 has improved the income situation of many workers in the low-wage sector. There have been clear wage increases for those on the lowest incomes, particularly in the eastern part of Germany. In numerous cases, the minimum wage must also have helped mini-jobs to be changed into jobs subject to social insurance payments. The Federal Government welcomes both developments. Negative macroeconomic employment effects have not yet been observed. This year, the Minimum Wage Commission, which mainly consists of representatives of the social partners, will review the level of the minimum wage for the first time.

30. Contracts for work and services and the supply of temporary workers are important instruments in an economy based on the division of labour, and enable companies to respond quickly to changing needs. The Federal Government therefore believes that both contracts for work and services and temporary agency workers are indispensable. However, effective action must be taken against illegal clauses in contracts for work and services. Also, the practice of supplying temporary agency workers should be oriented more to its core function.

31. Digitisation can also help to develop efficiency reserves and to improve care in the health sector. Big data appli-

cations can further improve understanding of how diseases arise. The eHealth Act will adapt the legal framework for a secure and trusted infrastructure – the telematic infrastructure – to current developments.

32. It is necessary to adapt the training of nurses to the changed supply structures and needs for nursing care and to make the training more attractive so that Germany can meet its growing need for skilled workers in the field of care for the elderly. In addition to the question of an adequate supply of skilled workers, the Federal Government is also addressing the quality of nursing care. The Federal Government's Second Act to Strengthen Long-term Care is creating a new definition of the "need for long-term care", in which such care is guaranteed equally for people with physical and mental disabilities.

33. The energy transition is one of the Federal Government's key projects. The aim is to achieve an environmentally compatible and affordable energy supply whilst maintaining competitiveness and security of supply.

34. In terms of the expansion of renewable energy in the electricity sector, Germany is on course to meet the challenging targets it has set itself. From 2017, the funding rates for renewable energy are generally to be set by auction. This aims to make the funding more cost-effective, and to ensure that the path of expansion for renewable energy set out in the 2014 Renewable Energy Sources Act is adhered to. At the same time, stakeholder diversity is to be maintained. The specific auction models for the various renewable energy technologies are to be stipulated this year in a revision of the Renewable Energy Sources Act.

35. In order to guarantee security of supply on the electricity market in the face of rising shares of renewables-based electricity, the Federal Government is further developing the electricity market in the form of the Electricity Market Act. The aim is to strengthen market forces, to activate potential for flexibility, to increase transparency and to improve the European integration of the electricity market. In exceptional situations, a capacity reserve is to safeguard supply. Digital technologies are also making a major contribution towards the future flexibility of the electricity market. The Act on the Digitisation of the Energy Transition is intended to permit the legal basis to be put in place for a broad use of digital innovations in the energy sector.

36. Germany intends to meet its national climate targets. In order to attain the necessary cuts in greenhouse gas emissions, the Federal Government is banking on the

additional climate change mitigation measures contained in the Climate Action Programme 2020 to close the reduction gap; these include the expansion of renewable energy and numerous measures to increase energy efficiency. As well as this, more use is to be made of low-emission CHP installations in the energy sector. A further contribution is made by the placing of older and inefficient lignite power stations on "security stand-by" and by other efficiency measures. On top of this, the Federal Government intends to adopt the 2050 Climate Action Plan in the summer of 2016. In addition to the national climate change mitigation efforts, the Federal Government is also calling for the implementation of the European and international climate targets and the continuation of the reform of European emissions trading adopted in 2015.

37. Boosting energy efficiency is important for the success of the energy transition and helps to mitigate climate change. Many of the measures adopted in the National Action Plan on Energy Efficiency were rolled out in the course of 2015. Building on the Action Plan, the Federal Government has also adopted the Energy Efficiency Strategy for Buildings. This Strategy shows how the goals of energy and climate policy can be achieved in the buildings sector.

38. Grid expansion is the backbone of a successful energy transition. The Act on Underground Cabling has put the policies in place for expanding the grid more quickly and gaining more public acceptance for it. Since a large proportion of the electricity from renewable energy is fed directly into the distribution grid, grid expansion at distribution grid level plays a key role in determining the success of the energy transition.

39. Energy research paves the way for the future of the energy supply. In addition to energy efficiency and renewable energy, the Federal Government's funding policy also focuses on new grid technologies and energy storage.

40. The financial market reforms aim at a lasting strengthening of confidence in the financial sector and to protect the tax payer from having once more to rescue financial institutions in difficulty. In the market economy, those who take risks should be liable for them. A common approach is required at international level in order to stop market players from shifting across to less strictly regulated areas. For this reason, the Federal Government is calling for common European and international rules. The Federal Government will continue to work actively on the Commission's initiative to form a capital market union. Also, the Federal Government is improving the protection enjoyed by investors.

41. The entry into force of a single resolution mechanism at the beginning of this year means that the euro countries now have common instruments for the resolution of banks whose difficulties might pose a danger to the stability of the monetary union. The Federal Government explicitly rejects the European Commission's proposal for European deposit insurance. The Federal Government believes that this would create false incentives for Member States and banks, as financial risks would be shifted from the national banking sector to European level.

42. In the First and envisaged Second Act amending Financial Market Legislation, the Federal Government is implementing European rules to improve the transparency and integrity of the capital markets and investor protection. Also, the Federal Government has tightened up the transparency rules for securities traded on the stock exchanges. The Federal Government is continuing to press for the introduction of a financial transaction tax. It should be imposed on all financial instruments, wherever possible. It is important to avoid negative effects on small investors, the real economy and pension provision, as well as undesired shifts in the financial sector.

43. The work to deepen the Economic and Monetary Union must be continued. In the view of the Federal Government, the goal of future reforms must be to develop an internationally competitive Economic and Monetary Union which fulfils the promise of the European Union to promote democracy, the rule of law, security, stability, prosperity and jobs. This includes stable public finances, a modern polity, attractive investment conditions and an open single market. An important step towards reaching this goal is to implement measures that have already been adopted and to credibly comply with and apply existing rules and procedures. Furthermore, it is important to develop a long-term vision of the institutional future of the Economic and Monetary Union. This includes a willingness to consider treaty changes.

44. The economic and financial crisis saw a slowdown in private-sector investment activity which in some cases is continuing to this day. For this reason, the European Commission launched an investment initiative in November 2014. The European Fund for Strategic Investment (EFSI) is a key element of this initiative. Germany will substantially support the European investment initiative and provide approx. €8 billion via the KfW to finance EFSI projects.

45. Boosting the employment – particularly of young people – is one of the key challenges for Europe in view of continuing high youth unemployment in some Mem-

ber States. The Federal Government is involved in numerous programmes in the context of European employment policy, and is also carrying out its own measures.

46. The Federal Government advocates a trade policy based on opening up markets, also to countries and regions outside Europe. At the same time, the multilateral trading system remains the focus of European and German trade policy. Strengthening the World Trade Organization is therefore an important policy of the Federal Government. In view of the bogged-down negotiations in the current world trade round, the Federal Government is interested in more flexible, plurilateral negotiation formats. These should be engaged in with a view to subsequently feeding the outcomes into the WTO framework.

47. The aim of the talks on a transatlantic trade and investment partnership (TTIP) is to open the markets further on both sides of the Atlantic and to conduct a transatlantic regulatory dialogue. Here, the Federal Government aims to ensure that high standards of protection, particularly in the field of protection for the environment, workers, consumers and data, as well as IT security and public services, can be maintained or put in place, and that the precautionary principle is retained.

48. The Federal Government is boosting transparency in the sensitive area of military equipment exports by providing rapid and comprehensive information about licensed exports. The Federal Government is sticking to its strict rules governing the export of military equipment. It has further tightened the rules on small arms exports.

49. Economic growth is an essential foundation of prosperity in Germany. Strengthening economic growth is therefore a major goal of the Federal Government's economic and fiscal policy. The focus of economic and fiscal policy considerations is not only on the level of growth, but also on the quality of growth. Together with the business community and other stakeholders, the Federal Government is pursuing the goal of economically, environmentally and socially sustainable development. Not least, it is guided by the United Nations' 2030 Agenda for Sustainable Development and implementing this in Germany.

50. In the government strategy entitled "Living well in Germany – what's important to us", the Federal Government has embarked on the debate about economic growth and quality of life, as well as concepts to measure

well-being. By the end of the first half of 2016, it will present a report which contains an up-to-date system of indicators and reporting on quality of life in Germany and which is to provide – alongside the goals and indicators of the national sustainability strategy – orientation for the future policies of the Federal Government.